December 1988 Monthly Survey January 9, 1989

Surveys of Consumers

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Interest Rate Concerns Reach Record Level

Third Small Monthly Decline In Index

The Index of Consumer Sentiment was 91.9 in the December 1988 survey, down from 93.0 in November. In each of the last three months of 1988 the Index fell by a small amount, declining a total of 5.4 Index-points from the 97.3 recorded in September. Despite this slowly declining trend, the Index nonetheless remained at a relatively favorable level. The December 1988 reading was higher than the December 1987 (86.8) and December 1986 (89.1) figures.

At present, rising interest rates represent the most troublesome aspect of current economic conditions for consumers. Interest rate increases have weakened attitudes toward buying conditions.

The fourth quarter declines were somewhat greater in consumers' evaluations of current economic conditions (102.0 in December, down from 109.4 in September) than in expected economic conditions (35.5 in December, down from 89.5 in September).

Among families with incomes of $40,000 or more, the Index stood at 99.5 in December, down from 101.0 in December and the 1988 high of 105.4 in September.

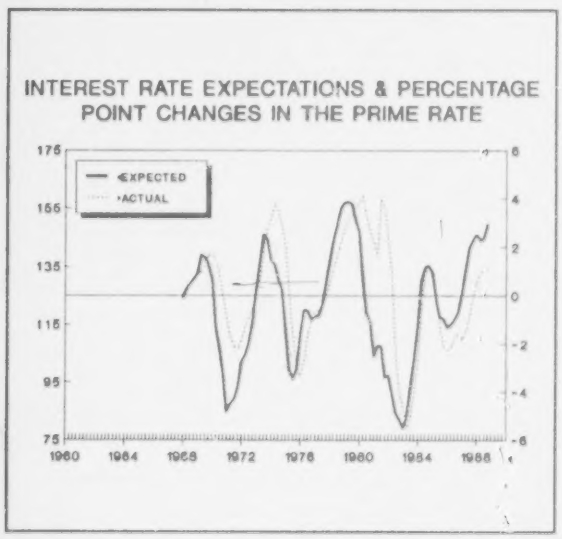
The December decline was not equally shared across all regions and age groups. Residents of the Northeast and Western regions recorded declines in the December 1988 survey. In contrast, residents of the Southern region posted an improvement, while consumer confidence among respondents residing in the North Central region remained unchanged. Importantly, only householders aged 55 or older recorded declines in consumer confidence in the December 1988 survey, while those under age 55 posted a small improvement.

Interest Rate Increases Expected by Record Numbers

Interest rates were expected to increase by 74 percent of all families in the December 1988 survey, the highest proportion recorded during the past 20 years. Just 7 percent of all families expected interest rates to decline during 1989.

During the past two years, interest rates increases have been the primary concern expressed by consumers about future economic prospects. These concerns first heightened in mid 1987, but by year-end were greatly reduced in the aftermath of the stock market crash. By the Summer of 1988 these concerns again significantly intensified, as the proportion that expected increases in interest rates rose from 44 percent in February to 71 percent in August. Following this surge, interest rate expectations eased, with the proportion that expected increases falling to 62 percent in November. The December 1988 survey reversed this modest improvement, leaving interest rates increases the dominant concern of consumers.

Consumers' interest rate expectations have proved to be remarkably consistent with actual subsequent developments. The chart below shows the correspondence between consumers' interest rate expectations and actual changes in the prime rate. Since consumer are asked about the direction of the expected change in interest rates, not their expected level, the annual percentage point change in the prime rate was used as the objective measure. Both consumers' expectations and the percentage point change in the prime rate are shown as four quarter moving averages. As can be seen from the chart, the interest rate expectations series foreshadows actual changes in the prime rate to a high degree. Consumer expectations changed two quarters in advance of the actual change in the prime rate, demonstrating a time series correlation of 0.78 with this lead.



Mortgage Rate Increases Weaken Home Buying Attitudes

Favorable home buying attitudes were held by 63 percent of all families in the December 1988 survey, down from 67 percent one month earlier, and the mid 1988 high of 73 percent. Although home buying attitudes still remain at relatively favorable levels, the December reading is substantially below the cyclical peak of 86 percent recorded in 1986. (To put this in perspective, the proportion holding favorable attitudes toward home buying conditions in December 1988 was more than four times higher than the recession low of 15 percent recorded in 1981.)

The major factor behind this growing weakness was rising mortgage interest rates. When asked to explain their view of home buying conditions, the proportion of families that mentioned the availability of low mortgage rates fell sharply, to 19 percent in December from 33 percent in November and the 1988 high of 47 percent recorded in March. Complaints about high mortgage interest rates rose to 18 percent in December from 12 percent in November and 9 percent in March. Although still relatively low, the number of families that registered complaints about high mortgage rates in December was the highest in three years.

The immediate negative impact of rising mortgage rate was partially offset by expectations that mortgage rates would increase even more in the future. The advantage of borrowing-in-advance of rising mortgage rates was cited by 21 percent of all families in December, up from 13 percent in November. Although this will help to soften the immediate impact of rising mortgage rates on home sales, it also acts to weaken future sales prospects insofar as it simply speeds up the timing of planned purchases.

Vehicle Buying Attitudes Remained Unchanged

Favorable vehicle buying attitudes were held by 61 percent of all families in the December 1988 survey, unchanged from the month earlier reading. In fact, the proportion of families holding favorable vehicle buying attitudes has remained largely unchanged throughout the last half of 1988, staying in the narrow range of 60 to 62 percent.

Although remaining at relatively positive levels, vehicle buying attitudes are now significantly lower

than at the cyclical peak recorded two years earlier. The primary reason for the decline from the prior peak has been the cutback in purchase incentives in the form of discounted interest rates offered by vehicle manufacturers. Because of this earlier decline in the availability of discounted interest rates on vehicle loans, the recent increases in interest rates have thus far only had a modest further impact on vehicle buying attitudes. References to the availability of low interest rates on vehicle loans declined from 14 percent in November to 11 percent in December, which was only half the level recorded one year earlier, and a fourth of the two year earlier reading.

Buying Conditions for Durables Viewed Favorably

Favorable attitudes toward buying conditions for furniture, appliances and home electronics declined slightly but remained at favorable levels. In the December 1988 survey, 70 percent of all families held favorable attitudes toward buying conditions for household durables, down from 73 percent in November, and 79 percent in mid 1988.

The small decline since mid year has been due to somewhat less favorable perceptions of market prices for household durables. Favorable perceptions of prices for furniture, appliances, and home electronics fell to 32 percent in December from 34 percent in July, while unfavorable price perceptions rose to 11 from 6 percent. Overall, consumers buying behavior remains highly sensitive to price discounts, with consumers willing to wait and time their purchases according to their availability.

Outlook for Economy Remains Favorable

Good times financially in the economy as a whole during 1989 were expected by 52 percent of all families in the December 1988 survey, just below the 53 percent recorded in November. Overall, consumers expected little change in the performance of the national economy, as the majority (59 percent) thought that economic conditions in 1989 would be the same as in 1988. The balance of consumers in the December 1988 survey were evenly split as to the future path of the economy--19 percent expected improvement and 19 percent expected worsening conditions.

The major factor underpinning this positive outlook is favorable employment prospects. In the December 1988 survey, 55 percent of all families expected the national unemployment rate to remain largely unchanged during 1989 from its current ten year low.

Inflation Concerns Ease But Remain High

The annual inflation rate was expected to average 5.0% in the December 1988 survey, down from the 5.4% expected in November, but substantially above the 4.0% recorded in December of 1987. The December 1988 reading was the lowest rate recorded since June 1988, when the expected inflation rate rose to 5.6%. Nonetheless, the second half of 1988 recorded the highest inflation expectations since the start of the current expansion.

Personal Finances

Consumers' assessments of their own financial situation weakened in the closing months of 1988. Among all families in the December 1988 survey, 39 percent reported that their financial situation had improved during the past year. Although this reading was largely unchanged from the October and November surveys, it was substantially below the 49 percent recorded in September and the twenty year peak of 50 percent recorded in August. While the overall level of these personal financial evaluations remains relatively favorable, the fourth quarter 1988 level was among the least positive readings recorded during the current expansion.

When asked to explain how their financial situation

had changed during the past year, fewer families reported income increases in the December 1988 survey (35 percent) than three months earlier (40 percent), and more families reported income declines in December (17 percent) than in September (12 percent).

Despite the weakness in their current financial situation since mid 1988, families continued to assess their future financial prospects in a positive fashion. Among all families in the December 1988 survey, 39 percent expected their financial situation to improve during 1989, between the 37 percent recorded in November and the 41 percent recorded in September, and above the 32 percent recorded in December of 1987.

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The December 1988 survey included 500 completed interviews, conducted between December 1 and December 23, 1988.